

BILL ANALYSIS

Senate Research Center
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S.B. 1094
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Natural Resources
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Texas law provides that when Texas oil and gas producers sell their oil and gas production to a first purchaser, a lien attaches to both the oil and gas production sold and to the proceeds of the production owned by, received by, or due to the first purchaser. This lien is intended to secure the obligations of the first purchaser to pay for the oil and gas purchased. This lien, however, was recently challenged in *Arrow Oil & Gas, Inc., v. SemCrude, L.P.*, a 2009 Delaware bankruptcy case.

In the *SemCrude* case, SemCrude, a conglomerate of companies formed in Delaware and Oklahoma that conducts oil and gas services, purchased oil and gas from Texas producers. SemCrude sold that oil and gas to subsequent purchasers, who paid SemCrude in full. SemCrude deposited the proceeds in its accounts in Oklahoma banks, then filed for Chapter 11 Bankruptcy before paying the Texas producers for their oil and gas. A dispute arose between the Texas producers and the debtors' banks as to which entity had the senior lien on the debtors' assets and was thus entitled to first payment from the debtors.

Ultimately, the Delaware court ruled that the Texas producers held unperfected security interests in the oil and gas they sold to the first purchaser (SemCrude) and in the proceeds from the first purchaser's resale of the oil and gas, a holding clearly contrary to the provisions of the Section 9.343 (Oil and Gas Interests: Security Interest Perfected Without Filing; Statutory Lien), Business & Commerce Code. The banks thus had priority over the Texas producers' unperfected liens, and the Texas producers were not paid in full in the bankruptcy proceeding. Seeking full payment, the Texas producers subsequently filed suit against the subsequent, or downstream, purchasers, arguing that the security interests created by Texas law in favor of Texas producers still attached to the producers' oil and gas sold by SemCrude to the downstream purchasers.

As a result of the court's ruling in *SemCrude*, downstream purchasers that have already paid for oil and gas received from a first purchaser are now in danger of being found to be the involuntary guarantor or insurer of obligations of the first purchaser, and being required to pay for the same oil twice. The ruling has made those purchasers vulnerable to litigation and will potentially hinder competition for the purchase of oil and gas produced in Texas, as purchasers facing potential double liability will be hesitant to purchase such oil and gas.

S.B. 1094 protects Texas producers and eliminates potential double liability for downstream purchasers.

As proposed, S.B. 1094 amends current law relating to security interests in oil and gas production and its proceeds.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 9.301, Business & Commerce Code, as follows:

Sec. 9.301. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS. Defines "first purchaser" and "oil and gas production" in this section. Provides that the following rules, except as otherwise provided in Sections 9.303 through 9.306, determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1)-(3) Makes no changes to these subdivisions.

(4) the local law of the jurisdiction in which the wellhead or minehead is located, including, if applicable, the provisions of Section 9.343(b) (relating to provide that certain security interests are perfected automatically without the filing of a financial statement) that provide for the automatic perfection of a security interest, govern the perfection of a security interest against the first purchaser, regardless of the jurisdiction in which the first purchaser is organized, for oil and gas production owned by, received by, or due to the first purchaser and in the identifiable proceeds of that production owned by, received by, or due to the first purchaser, if the proceeds are oil or gas production, inventory of raw, refined, or manufactured oil or gas production, or rights to or products of any of those.

(5) for a purchase-money security interest against the first purchaser of oil and gas production or its proceeds, Sections 9.324(b) and 9.343(f) govern the priority of the purchase-money security interest, regardless of the jurisdiction in which the first purchaser is organized, or whether the purchase-money security interest was perfected by filing a financing statement, if the purchase-money security interest was also perfected automatically under Section 9.343(b).

SECTION 2. Amends Sections 9.324(b) and (c), Business & Commerce Code, as follows:

(b) Defines "first purchaser," "oil and gas production," and "subsequent purchaser" in this subsection. Provides that the provisions of this subsection apply regardless of the jurisdiction in which the first purchaser is organized. Provides that subject to Subsection (c) and except as otherwise provided in Subsection (g), a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in Section 9.330 (Priority of Purchaser of Chattel Paper or Instrument), and, except as otherwise provided in Section 9.327 (Priority of Security Interests in Deposit Account), also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer or, in the case of identifiable cash proceeds from oil and gas production or its proceeds, to the extent the identifiable cash proceeds are owned by, received by, or due to the first purchaser on or before the delivery of the inventory to a subsequent purchaser, if:

(1) the purchase-money security interest is perfected automatically under Section 9.343(b) or in another authorized manner when the debtor receives possession of the inventory;

(2) except where excused by Section 9.343 (oil and gas production), the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(3) the holder of the conflicting security interest receives any required notification within five years before the debtor receives possession of the inventory; and

(4) the notification, if notification is required, states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

(c) Provides that Subsections (b)(2)-(4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory in a certain manner, including before the date of the filing, if the purchase-money security interest is perfected only by filing, and is not also perfected automatically under Section 9.343(b). Makes a nonsubstantive change.

SECTION 3. Amends Section 9.343, Business & Commerce Code, by amending Subsections (c), (f), and (g) and adding Subsection (k-1), as follows:

(c) Provides that the security interest exists in oil and gas production owned by, received by, or due to the first purchaser and in the identifiable proceeds of that production owned by, received by, or due to the first purchaser for an unlimited time if the proceeds meet certain criteria, including if the proceeds are oil or gas production, inventory of raw, refined, or manufactured oil or gas production, or rights to or products of any of those, although the sale of those proceeds to a subsequent purchaser cuts off the security interest in those proceeds, rather than the sale of those proceeds by a first purchaser to a buyer in the ordinary course of business as provided in Subsection (e) cuts off the security interest in those proceeds.

(f) Provides that the security interests and all liens created by this section have certain priorities over other Chapter 9 security interests, including a security interest created by this section, whether perfected automatically under Subsection (b) or perfected by the filing of the optional financing statement authorized by Section 9.5055, is treated as a purchase-money security interest for purposes of determining its relative priority under Section 9.324 over other security interests not provided for by this section.

(g) Provides that the security interests and liens created by this section have certain priorities among themselves, including:

(1) Regardless of whether the optional financing statement authorized by Section 9.5055 was filed to perfect those security interests, if a record effective as a filed financing statement under Subsection (b) exists, the security interests perfected by that record have priority over a security interest automatically perfected without filing under Subsection (b).

(2) A security interest perfected automatically without filing under Subsection (b), or for which the optional financing statement authorized by Section 9.5055 was filed, if the security interest was also perfected automatically without filing under Subsection (b), has priority over a lien created under Subsection (d).

(3) Makes no change to this subdivision.

(k-1) Provides that the sale to a subsequent purchaser by the first purchaser of oil and gas production or the proceeds of that production, if the proceeds are oil or gas production, inventory of raw, refined, or manufactured oil or gas production, or rights to or products of any of those, cuts off the liens and security interests created by this section in the oil and gas production and its proceeds. Provides that the security interests and liens created by this section are subject to and do not impair or impact in any manner the exercise or enforcement by a subsequent purchaser of any rights, including rights of a secured creditor and rights of set-off, net-out, exchange, recoupment, or withholding of funds, provided under any enforceable contract or applicable law that governs the relationship between a subsequent purchaser and the first purchaser or an affiliate or representative of the first purchaser.

SECTION 4. Amends Section 9.343(r), Business & Commerce Code, by adding Subdivision (5), to define "subsequent purchaser."

SECTION 5. Amends Subchapter E, Chapter 9, Business & Commerce Code, by adding Section 9.5055, as follows:

Sec. 9.5055. OPTIONAL FINANCING STATEMENT FOR SECURITY INTEREST IN OIL AND GAS PRODUCTION AND ITS PROCEEDS. (a) Defines "first purchaser," "interest owner," "operator," and "oil and gas production" in this section.

(b) Provides that to the extent of a conflict between this section and another provision of this subchapter, this section prevails.

(c) Authorizes an interest owner or an operator acting on behalf of one or more interest owners, if a security interest in oil and gas production or its proceeds is perfected automatically under Section 9.343(b), to file a financing statement against the first purchaser in the jurisdiction in which the first purchaser is organized.

(d) Provides that a financing statement filed pursuant to this section is sufficient if it provides the name of the debtor, provides the name of the secured party or a representative of the secured party, and indicates the collateral covered by the financing statement.

SECTION 6. Repealer: Section 9.343(e) (relating to the security interests and liens created by this section having priority over any purchaser who is not a buyer in the ordinary course of the first purchaser's business), Business & Commerce Code.

Repealer: Section 9.343(m) (relating to a person who buys from a first purchaser ensuring that the person buys free and clear of an interest owner's security interest or statutory lien), Business & Commerce Code.

Repealer: Section 9.343(n) (relating to certain security interest and liens remaining effective), Business & Commerce Code.

SECTION 7. Provides that the changes in law made by this Act apply only to a civil action commenced on or after the effective date of this Act. Provides that a civil action commenced before the effective date of this Act is governed by the law in effect immediately before the effective date of this Act, and that law is continued in effect for that purpose.

SECTION 8. Effective date: upon passage, or September 1, 2013.